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DIRECTORATE OF  
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[ INTERNATIONAL MONETARY SITUATION: The package of proposals approved in Brussels yesterday has preserved a measure of unity in the Common Market, but difficult problems--and a residue of bitterness--remain.

US Mission sources affirm that the Germans initially proposed that all community currencies be permitted to float in relation to the dollar, and offered monetary support to keep them within agreed margins. Although this would have been a step toward monetary union in the community, none of the other members--France and Italy in particular--was prepared to go this far and the proposal was rejected.

The compromise that was finally worked out will permit Bonn instead to allow the mark to float, apparently within limits and for an unspecified period of time. At a press conference last night, Economics Minister Schiller said it remains his government's "present aim" to return eventually to the prefloating rate of exchange.

Of the four other countries which joined West Germany last week in discontinuing official trading in dollars, only the Netherlands is again following the German lead in allowing its currency to float against the dollar. Switzerland and Austria have revalued their currencies outright, and Belgium evidently intends to rely on its dual exchange rate system. The French and Italians have announced their intention to maintain their present parities.

The stopgap of floating rates will have to be supplemented by additional measures. Floating of the mark will be accompanied by a renewal of domestic controls on the inflow of foreign funds into Germany. It may be difficult for the community to agree on how to control capital movements and to regulate the Eurodollar market.

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【 If the float of the mark is held to about 2.5 percent on either side of parity in order to limit the adverse effects on the Common Agricultural Policy (CAP), speculators may still believe that the mark is undervalued. On the other hand, a wider fluctuation would be severely disruptive of the CAP and measures would have to be taken to compensate the German farmer, who will receive less as the mark floats upward. Bonn nevertheless has agreed not to take unilateral measures to help its farmers pending an attempt by the ministers to find a community solution at a meeting tomorrow.

French Finance Minister Giscard d'Estaing has publicly acknowledged that the need to resort to the measures approved yesterday will make it impossible for the Six to narrow their exchange rate margins on 15 June as they had intended to do in keeping with the projected plan for monetary union. Whether the delay will be a prolonged one will obviously depend on how the money markets respond to the various stabilization measures.

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EC-UK: The ministerial level meetings early this week will open a drive to settle by summer the main issues involved in Britain's bid for Common Market membership.

At the meeting of the ministers of the Six today, France has promised to propose a solution to the problem of Britain's contribution to the community budget. The negotiations have been deadlocked on this issue since last December, and if France's proposal is approved by the Six, it will be considered when they meet with the UK tomorrow and Wednesday. At that time, the problems of continued access to an enlarged community for New Zealand dairy products and Commonwealth sugar will also be discussed.

The French proposal on financing will apparently be a formula rather than a precise figure. The fact that Paris is taking the initiative on this issue marks a change from the earlier French position which left the next move up to London. Following a talk with President Pompidou last week, New Zealand Prime Minister Holyoake confirmed that Paris may also suggest that the dairy and sugar problems simply be set aside until after British entry, with the understanding that they then would be dealt with fairly.

It is highly doubtful that the seven can fully settle these issues in a two-day meeting--the Six had already agreed with the British in March that an additional session could be held later this month if necessary. Paris has been strongly urged by its EC partners to be more forthcoming, however, and its new proposal on financing may be a sign of increased flexibility.

The announcement over the weekend that Prime Minister Heath will discuss the accession issue with President Pompidou in Paris on 20-21 May is a reversal of London's previous position regarding such a meeting. Why Heath has changed his mind is

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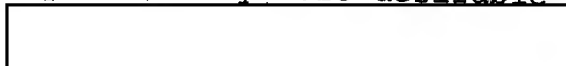
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unclear. It has long been speculated that Pompidou might seek at such a meeting to extract concessions from Heath in return for entry, but the monetary crisis of the past week--in which German economic pre-eminence again became apparent--may have made Britain's accession seem politically more desirable to Paris than before.



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INDIA-PAKISTAN: Relations continue strained as a result of the impasse over the repatriation of diplomatic personnel from Calcutta and Dacca and the mounting influx of East Pakistani refugees into India.

No progress has been made in recent days on the repatriation issue, with Pakistan continuing to insist that its specially assigned representative in Calcutta be allowed individual interviews with those members of the staff of Pakistan's Deputy High Commission who have opted for Bangla Desh. Indian officials, however, claim they have no power to force the disaffected Pakistanis to meet one-by-one with Islamabad's representative. Until such interviews take place, the Pakistanis refuse to schedule the reciprocal exchange of personnel.

Meanwhile, New Delhi charges that its deputy high commissioner in Dacca, Sen Gupta, and his staff are still being subjected to severe restrictions on movement and communication and that some of the staff may now be running out of food. The US consul general in Dacca was turned back by a Pakistani Army officer when he attempted to call on Gupta on 8 May. The officer also volunteered that he was under strict orders not to allow Gupta outside the compound where he resides.

The refugee issue may be aired today in the UN Economic and Social Council (ECOSOC) if India obtains permission to speak on the situation in East Pakistan. Islamabad is expected to insist that the issue is an internal matter, not subject to debate before ECOSOC or any other international body. The Indians plan to charge the government of Pakistan with committing "atrocities and barbarities" that have resulted in massive numbers of refugees fleeing across the border of East Pakistan into neighboring Indian states. According to a senior Indian official, the Indian representative will also demand that a way be found to relieve the

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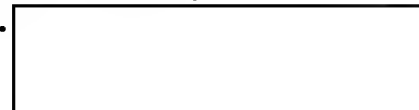
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East Pakistanis from the "oppression" they currently suffer. The same official claims that a "conservative" estimate of the number of refugees presently in India is 1.8 million and that the influx is growing daily, with no end in sight.



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